

STATE OF MICHIGAN  
STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES  
FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

\* \* \* \* \*

In the matter of the application of )  
**Michigan Consolidated Gas Company** )  
for approval of a gas cost recovery plan, )  
5-year forecast, and monthly GCR factors )  
for the 12 months ending March 31, 2011. )  
\_\_\_\_\_)

Case No. U-16146

**NOTICE OF PROPOSAL FOR DECISION**

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on August 5, 2010.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before August 19, 2010, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before August 30, 2010. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing of exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for

Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

STATE OFFICE OF ADMINISTRATIVE  
HEARINGS AND RULES  
For the Michigan Public Service Commission

---

Barbara A. Stump  
Administrative Law Judge

August 5, 2010  
Lansing, Michigan  
dmp

STATE OF MICHIGAN  
STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES  
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

\* \* \* \* \*

In the matter of the application of )  
**Michigan Consolidated Gas Company** )  
for approval of a gas cost recovery plan, )  
5-year forecast, and monthly GCR factors )  
for the 12 months ending March 31, 2011. )  
\_\_\_\_\_ )

Case No. U-16146

**PROPOSAL FOR DECISION**

**HISTORY OF PROCEEDINGS**

On December 30, 2009, Michigan Consolidated Gas Company (Mich Con or the Company) filed an application, along with supporting testimony and exhibits, pursuant to 1982 PA 304 (Act 304), MCL 460.6h *et seq.*, for approval of a gas cost recovery (GCR) plan and GCR factors for the 12-month period ending March 31, 2011. Specifically, Mich Con requests that it be permitted to implement a maximum base GCR factor of \$7.06 per thousand cubic feet (Mcf) that can be increased by a contingency factor matrix based on increases in the New York Mercantile Exchange (NYMEX) gas commodity prices. Mich Con also requests that the Commission approve its five-year forecast, and that certain financing costs be recoverable as booked costs of gas.

A prehearing conference was held on February 4, 2010, at which time the Administrative Law Judge granted the petitions to intervene filed by the Residential Ratepayer Consortium (RRC), the Michigan Community Action Agency Association (MCAAA), and Attorney General Michael A. Cox (Attorney General). She denied the

petition to intervene filed by Direct Energy Services, LLC, and Interstate Gas Supply, Inc. The Commission Staff (Staff) participated in the proceedings.

Cross-examination was held on May 25, 2010, at which time Mich Con presented the testimony of six witnesses. MCAAA presented the testimony of two witnesses, while the RRC, the Attorney General, and the Staff each presented the testimony of one witness.

The parties filed briefs and reply briefs on June 25, 2010 and July 16, 2010, respectively. The record consists of 530 pages of transcript and 62 exhibits that were admitted into evidence.

## **DISCUSSION AND FINDINGS**

### **Mich Con's Sales Forecast and Supply Costs**

George H. Chapel, Manager of Market Forecasting for Mich Con, testified regarding the Company's GCR market forecast, plan, and gas supply strategy for the five-year operational period 2010-2015. Mr. Chapel testified that for the April 2010 – March 2011 operational plan year, he forecasted sales volumes of approximately 151 billion cubic feet (Bcf) to 1.19 million rate schedule sales customers, including gas choice customers (GCC). He also forecasted that the number of rate schedule customers would decline from 1.19 million to approximately 1.11 million in 2014-2015. (2 Tr 150; Exhibit A-1, p. 2.) Mr. Chapel explained that this projected reduction in customers is due to forecasts of substantial population declines in Wayne County as a result of the weak economy in this segment of Mich Con's service territory. It is also the result of steps Mich Con is taking in meter locking and cutting of service to customers for non-payment. (2 Tr 151.)

Eric W. Clinton, a Principal Analyst in Mich Con's Gas Supply and Planning Organization, testified regarding the Company's projected total gas purchase quantities and costs for the April 2010 – March 2011 operational plan year, which includes the categories of contracted fixed price, contracted indexed price, and supply not yet under contract. These quantities and costs are summarized on Exhibit A-11, while transportation costs, which total approximately \$59 million, are shown on Exhibit A-12. Mr. Clinton stated that the total delivered supply cost for the 2010-2011 GCR period is approximately \$878 million as shown on Exhibit A-13. After adjusting for fuel and heating value, the total delivered gas supply for the 2010-2011 GCR period is 123 Bcf. (2 Tr 235-236.)

#### Weather Normalization

Mr. Chapel testified that weather normalization adjusts actual volumes from a past period to eliminate the effect of warmer or colder than normal weather during that time period. Weather normalized historical consumption is then used to forecast future consumption. (2 Tr 151.) A key issue in this case centers on the type of weather normalization to use in establishing historical use.

Mr. Chapel explained that, historically, Mich Con has used a 30-year period, 1973-2002, as normal weather to project usage in the Company's GCR filings up through the 2008-2009 GCR plan filing. However, in last year's GCR filing, Case No. U-15701, Mich Con used a 10-year weather normal based upon 1998-2007. The Commission approved that method in its November 12, 2009 order in Case No. U-15701.

In this case, Mr. Chapel testified that, consistent with its weather normalization selection in its most recent rate case, Case No. U-15985, Mich Con has decided to use a hinge fit normal weather pattern to project its demand requirements. (2 Tr 151-152.) Mr. Chapel sponsored Exhibit A-7, a 22-page document that performs a residual analysis for all seven of Mich Con's service regions. He revised Exhibit A-7 in his rebuttal testimony to correct an error in his calculations. He stated that Revised Exhibit A-7 comports with the hinge fit calculations made in Case No. U-15985. Mr. Chapel testified that this analysis continues to confirm that using hinge fit normal weather provides more accurate heating degree days for normalization and normal weather forecast purposes. (2 Tr 169.)

Frank J. Hollewa, an independent energy consultant, testified on behalf of the RRC. Mr. Hollewa testified that based on his analysis, the 15-year rolling average normal is the most accurate forecast methodology. In Mr. Hollewa's view, the hinge fit method is the least accurate methodology for forecasting gas supply. (2 Tr 404.)

The Attorney General presented the testimony of Ralph E. Miller, an independent consulting economist. Mr. Miller reviewed Mr. Chapel's testimony and exhibits on the hinge fit method, and he also examined the testimony of Mich Con's witness, Robert E. Livezey, on this topic in Case No. U-15985. Although Mr. Miller stated that he has some concerns about the way Mich Con has implemented the hinge fit method for GCR purposes, he was not presenting those concerns unless and until the Commission approves that method. (2 Tr 417.)

In its June 3, 2010 order in Case No. U-15985, the Commission found that the sales volumes should be weather normalized using a 15-year rolling average as

proposed by the RRC. In doing so, the Commission rejected the hinge fit method, finding that it is untested in the area of utility regulation. The Commission also noted that while the 30-year normalization method fails to reasonably reflect the warming trends since the 1970's, the hinge fit method appears to exaggerate the warming trend.

In its brief, Mich Con acknowledges that the Commission adopted a 15-year normal method of forecasting in Case No. U-15985. However, the Company contends that the Commission's decision does not make this issue moot in this case, because a normal weather forecast serves a different purpose in a GCR plan case than in a general service rate case. More specifically, Mich Con states that the normal weather forecast in a GCR proceeding is an integral component of determining the amount of gas sales expected over the plan period. As a result, it submits that the impact of the normal weather forecast on the establishment of a maximum GCR factor for the plan period is direct and immediate. In contrast, Mich Con asserts that in establishing general service rates, the impact of the normal weather forecast is far more indirect and has a significantly lower impact on the resultant general service rates, because the vast majority of the costs to be recovered from those rates are sunk costs related to infrastructure, administration, and labor, which are unaffected by changes in weather.

The Administrative Law Judge finds that the Commission has already spoken on this issue and adopted the 15-year rolling average method of weather normalization. As a result, this issue is moot. In arguing that the issue is not moot for purposes of this case, Mich Con ignores the fact that the primary reason the Commission rejected the hinge fit method is that it is untested in "the area of utility regulation." In reaching this conclusion, the Commission did not distinguish between rate cases and GCR plan

cases. Mich Con's arguments regarding the different purposes weather normalization serves in GCR cases and rate cases are not fully developed and are not supported by any evidence. As noted earlier, the purpose of using weather normalized historical consumption is to forecast future consumption, which is equally applicable in both rate cases and GCR cases. Thus, the Administrative Law Judge is unable to determine exactly what different purposes Mich Con is referencing. As a result, she can only conclude that Mich Con's arguments simply reflect its disagreement with the Commission's rejection of the hinge fit method and, consequently, its unwillingness to concede that the issue is moot. The Administrative Law Judge therefore recommends that, consistent with its findings in Case No. U-15985, the Commission adopt the 15-year rolling average method of weather normalization in this case.

#### Fixed Price Purchase Guidelines

Mr. Clinton testified that Mich Con's five-year supply plan features a reasonably flexible portfolio of geographically diverse sources of supply under short- to long-term supply and transportation contracts. He stated that the supply plan also contains a comprehensive new fixed price purchase program strategy. Mr. Clinton indicated that Mich Con will operate under the plan the Commission approved in Case No. U-15701 until the Commission approves its newly proposed fixed price purchase guidelines. (2 Tr 210.)

More specifically, Mr. Clinton explained that Mich Con is proposing to completely eliminate the current fixed price guidelines and replace them with the guidelines contained in Exhibit A-8. According to Mr. Clinton, the current guidelines are overly complex and deficient, because they rely on price dependent triggers that are based on

historical price analysis or technical analysis irrespective of market fundamentals. As a result, he stated that market speculation is inherent in price dependent triggers. In contrast, Mr. Clinton testified that a reasonable and prudent fixed price purchase program should achieve the following objectives: (1) mitigate the impact of market price volatility on the GCR factor; (2) allow participation in downward price movements; (3) limit the impact of upward price movements; (4) utilize a prescriptive methodology that limits speculation; (5) ensure simplicity by utilizing a methodology that is not overly complex; (6) provide year-over-year GCR factor stability and price certainty for customers; (7) and allow Mich Con to properly size credit facilities and reduce borrowing costs. (2 Tr 212-213.)

In light of these objectives, Mr. Clinton stated that Mich Con analyzed four strategic alternatives: (1) 100% spot purchases, i.e., Zero Hedge, (2) volume cost averaging (VCA), (3) price caps, and (4) collars. Mr. Clinton explained that Zero Hedge operates by buying all gas supply at spot market prices or at prices indexed to the spot market. The VCA method is a timing technique of purchasing an equal volume of natural gas on a regular schedule at a fixed price. Price caps are a type of firm purchase that requires the buyer to pay a premium (similar to an insurance premium) to ensure that the purchase price does not exceed a pre-specified cap or ceiling price. Collars are similar to caps in that they provide a price ceiling in addition to a price floor by requiring a premium payment for the ceiling that is offset by an obligation to purchase gas at a floor price, thereby making the collar cost neutral. (2 Tr 212-214.)

Based on its analysis of each of these strategies, Mich Con determined that the VCA method meets all of the objectives of a reasonable and prudent program for

purchasing fixed price gas. More specifically, Mr. Clinton stated that the VCA method requires the purchase of fixed volumes equal to 75% of the Company's annual purchase requirements. Mich Con would lock in  $1/24^{\text{th}}$  of that volume at fixed prices each month for 24 consecutive months starting 27 months prior to the start of the GCR plan year. For example, he stated, assuming the April 2013 through March 2014 GCR period, the Company would purchase 3.1% (75% divided by 24 purchases) of the Company's total purchase requirements each month beginning in January 2010 and extending through December 2011. Mr. Clinton indicated that this results in a 37.5% fixed price coverage ratio 15 months in advance of the GCR period, and 75% fixed price coverage ratio three months in advance of the GCR period. (2 Tr 217.)

Mr. Clinton went on to state that the VCA guidelines would protect customers against upward price movements and allow for downward price participation. Specifically, only 3.9% of the gas supply would be exposed to any temporary price spike in any given month. Conversely, if prices decline in subsequent months, customers will participate in the downside price movements, because fixed price purchases will be made during that period as well. In other words, Mr. Clinton testified that VCA spreads risk evenly over time and volumes, as opposed to the current program, which has a tendency to make large lump sum purchases over a short period of time in a rapidly falling price environment. He also stated that VCA provides the additional benefit of eliminating price speculation by fixing each monthly purchase regardless of price, so that the purchases are time dependent rather than price dependent. In short, Mr. Clinton testified that protection from price risk and volatility are

provided under the VCA method through equal volume purchases executed monthly over a defined period of time well in advance of the delivery month. (2 Tr 217-218.)

Mr. Clinton further indicated that the fixed price guidelines approved in Case No. U-15701 for the 2009-2010 GCR plan case will continue in effect until Mich Con receives an order approving the proposed changes. He also explained that at the time its application was filed in this case, Mich Con had secured 62% of its annual requirements under the current Commission-approved fixed price guidelines for the April 2010 through March 2011 period, 31% for the April 2011 through March 2012 period, and 6% for the April 2012 through March 2013 period. He explained that the 62% exceeds the 60% maximum fixed price coverage due to the migration of customers from GCR to the GCC program and projected load loss, which occurred after the fixed price purchases were made. (2 Tr 221.) As a result, Mich Con concludes that approval of the VCA method in this case will primarily affect subsequent GCR plan periods.

The Staff recommends that the Commission approve Mich Con's VCA purchasing method, because it finds it to be a reasonable method, and it supports the objectives the Company is attempting to achieve through use of this method. The Staff points out that the VCA method's end result of 75% fixed price supply is the same end result that was approved in Case No. U-15701. The Staff explains that, in Case No. U-15701, the main purchasing method used was the Quartile Indices Method (QIM), which was a price dependent purchasing guide that indicated when the current price was favorable as compared to historical prices. Using the QIM, the Company could fix the price of 75% of its supply requirements prior to the winter of the current plan year. The Staff states that the problem with the QIM method was that, in a rising market, Mich

Con would receive no purchasing indicators at all and, in a falling market, the Company would get several purchasing indicators very quickly and have all its fixed price purchases completed in a short amount of time. According to the Staff, this would leave the Company no opportunity to take advantage of gas prices should they continue to decline. Citing Mr. Clinton's testimony, the Staff states that the VCA purchasing method is a solution to both shortcomings of the QIM. The Staff concludes that the VCA method will ensure that Mich Con achieves the desired amount of fixed price supply to reduce market volatility and obtain an averaging effect in any type of pricing scenario by spreading multiple purchases over an extended period of time.

The RRC takes the position that Mich Con's proposed fixed price purchasing program should be rejected, because it is not reasonable and prudent. It begins its arguments by stating that to understand why Mich Con's fixed price purchasing proposal should not be approved, it is important to know the Company's past performance in making those purchases. On behalf of the RRC, Mr. Hollewa reviewed the financial results of Mich Con's fixed price purchasing program starting in the 2006-2007 period and developed estimates for the 2009-2010 GCR year based on data from discovery responses. The RRC states that the total increased cost of supply from the fixed price purchasing program when compared to purchases at monthly index totals over \$725 million during the four-year period. According to Mr. Hollewa, this is compelling evidence that the current fixed price purchasing programs are ineffective for the GCR customers from an economic standpoint. (2 Tr 386.)

Mr. Hollewa developed three exhibits using data from *Gas Daily*, a widely recognized publication that reports on the natural gas industry. They compare

purchases under Mich Con's proposed fixed price purchasing program with purchases at index prices. Exhibit RRC-1 shows the NYMEX projections for each 12-month period based on the First Trading Day, the Mid-Month Trading Day, the Last Trading Day, and the actual NYMEX for each of the 12-month periods starting from April 2006 through March 2010. According to the RRC, these exhibits show extreme price volatility. The NYMEX projections occurring in the same month for the same 12-month period exceed \$1.00 per Dexatherm (Dth) in eight out of 48 months. Exhibit RRC-1 also shows that the NYMEX actual was lower than the NYMEX projections in 31 out of 38 periods. Mr. Hollewa concluded that this data "clearly demonstrates the existence of an upward price bias, i.e., an optimistic expectation that natural gas prices will always increase in the future. Exhibit RRC-1 is the first piece of evidence that supports my conclusion that the FFP program is not effective as a means of attaining price stability in the natural gas marketplace." (2 Tr 388.)

Mr. Hollewa also prepared Exhibit RRC-2 to show the actual NYMEX close for each month for each of the last four GCR periods versus the actual monthly GCR factors billed by Mich Con. According to Mr. Hollewa, the data in that exhibit shows that there was a marked difference between the high and low GCR factors billed by the Company during each of those GCR periods. (2 Tr 389.) The RRC submits that, from the customer's standpoint, this is not price stability.

For the same four-year period, Mr. Hollewa also prepared Exhibit RRC-3 to show the city-gate delivered cost per Mcf for Mich Con only. Mr. Hollewa explained that he used a proxy for the city-gate delivered cost per Mcf based on the *Gas Daily* Mich Con

First of Month index price per Dth plus \$0.03 times 1020 Btu. Mr. Hollewa testified that Exhibit RRC-3 shows that:

. . . the actual monthly Citygate price was lower than the GCR Factor in 8 out of 12 months during the 2006-2007 GCR period; 7 out of 12 months during the 2007-2008 GCR period; 8 out of 12 month during the 2008-2009 GCR period; and lower in all 12 months during the 2009-2010 GCR period. This exhibit also shows that the actual average Citygate price was lower than the average GCR Factor by \$1.15/Mcf in 2006-2007, \$0.37/Mcf in 2007-2008, \$0.96 Mcf in 2008-2009 and \$3.50/Mcf in 2009-2010. (2 Tr 389.)

The RRC goes on to argue that in his testimony on Mich Con's VCA method, Mr. Clinton admitted that the Company's quantitative analysis "did not provide any incite into the performance of this method in random price environments that may occur in the future." (2 Tr 215.) The RRC points out that, on cross-examination, Mr. Clinton admitted that Mich Con is not sponsoring any evidence in this case that shows how the VCA method would have performed if implemented over an historical period. (2 Tr 270-271.) Moreover, the RRC states, Mr. Clinton admitted that Mich Con's selection of the VCA method does not provide a guarantee of future performance. (2 Tr 273.) He also admitted that the VCA method is not necessarily a more accurate predictor of price than using an historical analysis of prices. (2 Tr 276.)

In light of Mr. Hollewa's analysis and Mr. Clinton's statements on cross-examination, the RRC asserts that it would be unreasonable and imprudent for Mich Con to continue to use a fixed price purchasing method for 75% of its annual requirements, because it will do nothing more than lock in losses for GCR customers in the future. The RRC therefore recommends that the Commission discontinue all fixed price purchases. However, Mr. Hollewa provided an exception to this recommendation for the balance of the 2010-2011 GCR period. He stated that if the average NYMEX

strip price is \$5.00 or less, Mich Con would be permitted to buy up to 50% of the Winter 3010-2011 purchase requirements during the Fall 2010. He made this recommendation to **mitigate** any price spikes that might occur in the hurricane season. (2 Tr 393.)

Going forward into the later years of the five-year forecast, the RRC proposes that Mich Con secure firm supply using the criteria set forth in Mr. Hollewa's testimony:

1. Long term contracts for a year or more priced at Index plus or minus (usually a penny or two) for the applicable production area.
2. Seven-month contracts for the summer period based on NYMEX Close plus or minus a Fixed Basis adjustment for the applicable production area.
3. Five-month contracts for the winter period based on NYMEX Close plus or minus a Fixed Basis adjustment for the applicable production area.
4. Monthly purchases at the FOM Index plus or minus.
5. Monthly purchases at the NYMEX Close plus or minus a Bid Basis adjustment.
6. Fixed Price Purchases as detailed above in my testimony.

All of the above methods will result in secure firm supply with contractual obligations that are no different from the purchase of fixed price supply. My recommendation is to use Index, but the NYMEX Close plus or minus the Basis adjustment would be permitted for up to 50% of purchases. However, the use of a fixed Basis in conjunction with NYMEX close is limited to a maximum of seven months for the summer period and five months for the winter period in the current GCR Year only. (2 Tr 394.)

The RRC concludes that Mr. Hollewa's purchasing method is provided to show that there is a credible alternative to the Company's heavy reliance on the fixed price purchase methodology. For the out years of Mich Con's GCR plan, the RRC recommends that the Commission issue a warning that, based on present evidence, it

is unlikely to permit recovery of costs associated with its proposal to secure 75% of its supply using the VCA purchasing method.

On behalf of the Attorney General, Mr. Miller testified that the Commission should not approve Mich Con's proposed fixed price purchasing guidelines. Instead, he stated that the Commission should approve the guidelines adopted in its November 12, 2009 order in Case No. U-15701. However, he explained that the Commission should restrict the Company's reliance on those guidelines to contracts entered into by March 31, 2011, which is the last day of the annual GCR period. In the meantime, Mr. Miller recommended that the Commission wait for a report and any recommendations that may be forthcoming from the collaborative effort now being organized pursuant to prior Commission orders, including the order in Case No. U-15701. In his view, the Commission can use that information, along with the GCR plans for 2011-2012, as a basis for considering fixed price purchase guidelines to be effective after March 31, 2011.

Mr. Miller offered a number of reasons for his recommendation. Among others, he noted that the collaborative can reflect a pooling of the expertise and experience of all four large Michigan gas utilities and an opportunity for the Staff, the other parties, and ultimately the Commission to address gas purchasing strategies of all four in a common framework. In his view, this will likely lead to adoption of a better set of guidelines for each of them, consistent with the requirement in MCL 460.6h(6) to minimize GCR costs of gas sold as well as other relevant factors. Mr. Miller stated that the collaborative, not the present Mich Con GCR plan proceeding, is the first appropriate place to compare different strategies in a search for desirable new

approaches. Finally, he noted that the collaborative will also provide an opportunity for a deeper and more extensive analysis of alternative gas purchasing strategies than is possible in a GCR plan proceeding. (2 Tr 423-424.) Nevertheless, Mr. Miller stated that the Commission should make only the following changes to the guidelines:

Any new guidelines approved by the Commission should limit Second Quartile purchases under the QIM to quantities that will leave MichCon's fixed price coverage at no more than 30% of total requirements. If MichCon has already acquired fixed price contracts for 30% of its projected total requirements for any future GCR year, the guidelines should not allow any further purchases for that future GCR year at Second Quartile prices. This restriction on additional Second Quartile purchases would apply even if some (or perhaps all) of the 30% had been acquired at First Quartile prices. However, MichCon could continue making First Quartile purchases above 30% of projected total requirements in accord with the other provisions of the guidelines approved in U-15701. (2 Tr 425.)

MCAAA states that its position on this issue is not to discourage Mich Con's proposals but, rather, to suggest matters that should be considered in evaluating those proposals. It states that various aspects of Mich Con's proposals can be considered for partial adoption on an initial basis or as a pilot approach. However, MCAAA submits that caution must be exercised to ensure that revisions in the GCR planning process are made in a way that fully protects ratepayers and upholds the Commission's duties to carry out the purposes and objectives of Act 304.

On behalf of MCAAA, Geoffrey C. Crandall, a principal and Vice President of MSB Energy Associates, Inc., testified that Mich Con's VCA proposal should not be approved unless significantly modified. In Mr. Crandall's view, the VCA method is likely to be more costly to ratepayers than other methods. He explained that purchasing 75% of gas volumes on a fixed price basis beginning over two years before delivery means that ratepayers will not get the benefit of any price decreases that may occur between

the date the gas price was fixed and the date of delivery. According to Mr. Crandall, the additional cost of the VCA method is not sufficiently offset by commensurate benefits, such as reducing customer rate volatility, to justify the additional costs. He stated that the purchase of gas at market prices, or Zero Hedge, may be the least expensive option because, as noted in Mr. Clinton's testimony, the Zero Hedge results in exposure to only 12 prices within a GCR period which are the settled prices prior to the delivery month. (2 Tr 488, 490.)

Mr. Crandall recommended that the Commission reject Mich Con's proposed VCA method and, instead, adopt the Zero Hedge alternative, unless the Company can demonstrate that the alleged benefits of VCA offset the additional cost. He further stated that if the Commission adopts the Zero Hedge strategy, it should be structured to secure firm gas supplies under index prices for a substantial portion of the Company's gas requirement. He believes that 75% would be a reasonable target for longer term index contracts to ensure reliable supplies, while leaving 25% to shorter term and spot market sources to allow flexibility. In the alternative, Mr. Crandall recommended that, if the Commission adopts a VCA approach, it should consider lower levels of VCA. In his view, locking in the price on 75% of Mich Con's gas volumes is excessive, while locking in a lower level, such as 33%, may be more reasonable depending on the outcome of a further analysis. (2 Tr 503-504.)

The Administrative Law Judge finds that Mich Con's proposed VCA method is reasonable and prudent and should be adopted. The evidence demonstrates that the proposed VCA method will allow continual market participation over an extended period of time up to two years in advance of the GCR period. The Administrative Law Judge is

persuaded that this methodology is consistent with the philosophy that one should not try to “beat the market” but, rather, regularly participate in the market over an extended period of time. Such an approach is also a simple and effective way to manage price risk and reduce volatility.

In contrast, the RRC’s position that all fixed price purchases should be discontinued, with two exceptions, is not reasonable and prudent because it would expose customers to market volatility and could result in large year-over-year fluctuations in the GCR factor. In reaching this conclusion, the Administrative Law Judge rejects Mr. Hollewa’s analysis of historical fixed price purchases and theoretical VCA performance, because it uses historical data from only four prior GCR periods (October 2006 through January 2010) that reflect fixed price programs that are different than the VCA method proposed in this case. In short, the Administrative Law Judge agrees with Mich Con that Mr. Hollewa’s analysis is primarily an “apples-to-oranges” comparison that produces unreliable results.

Jennifer C. Schmidt, a Principal Project Manager for DTE Energy Corporate Services, LCC, explained why the Company’s past fixed price purchase programs are not useful in determining how the Company’s proposed VCA method will affect GCR factor stability. She stated that:

MichCon’s past FPPs are not useful in determining how MichCon’s proposed FPP will impact GCR factor stability because they operate differently from the proposed FPP. *The most important factor in determining how the FPP will affect GCR factor volatility is the volume of gas already contracted for at fixed prices prior to the filing of the GCR plan.* This relationship between prices fixed prior to the GCR plan year and GCR factor volatility occurs because the GCR factor is set based on Plan costs. Any changes from the Plan price levels will change the GCR factor necessary to recover GCR costs. (2 Tr 341-342, *emphasis added.*)

Ms. Schmidt presented a table showing the percentage of volumes of gas that were fixed price at the time of filing the six prior GCR plans. It shows that with the exception of the 2009-2010 plan, the Company's past fixed price plans did not result in a meaningful level of fixed prices prior to the plan filing. For example, in the 2004-2005 GCR period, only 15% of gas volumes were fixed price at the time of the plan filing; in the 2005-2006 and the 2006-2007 periods, 0% of gas volumes were fixed price at the time of filing; and in the 2007-2008 and 2008-2009 periods, 21% and 30% of gas volumes, respectively, were fixed price at the time of filing. Based on this information, Ms. Schmidt opined that prior fixed price purchase programs were not comparable to the currently proposed program and, consequently, the GCR factor changes during those periods are not good proxies to use in determining how certain price movements may or may not affect the GCR factor under its new program. (2 Tr 342.)

In contrast to prior plans, Ms. Schmidt testified that the VCA method protects against GCR factor volatility in the face of price increases. This is due to the fact that the VCA method fixes a larger percentage of volumes prior to the GCR filing. She explained that:

If 75% of prices are fixed before the year and market prices increase \$1.00 per Mcf, the GCR factor would only need to be increased \$0.50 per Mcf to recover that increased cost. The change, as explained in my rebuttal to Staff's position above, would be \$0.50 per Mcf and not \$0.25 per Mcf due to LIFO pricing used for the 2011 storage withdrawals. However, if no prices are fixed, prices increase \$1.00 per Mcf and subsequent to this increase 75% of prices are fixed, that fixing of prices represents no reduction in volatility from the \$1.00 per Mcf increase. In this case, the GCR factor would have to increase \$1.00 per Mcf to recover the increased costs resulting from the market price increase. The 75% would protect from further price movement but not the volatility that had already occurred. (2 Tr 343.)

Mich Con also effectively rebutted the RRC's criticism that the Company did not provide evidence that shows how the VCA method would have performed if implemented over a historical period. Mr. Clinton testified that the Company did, in fact, perform a quantitative historical back cast of the VCA method, along with the other methods it considered, i.e., Zero Hedge, price caps, and price collars. In performing the back cast analysis, Mr. Clinton explained that historical data was used to forecast the prices that would have been fixed if these different methods had been in effect at the time. (2 Tr 214.) He also explained why Mich Con did not present the back cast data itself in this case:

The results of the back cast varied and were skewed due to the predominant secular bull market in place over a majority of the historical period analyzed. The back cast results only reflected the market conditions present in this type of market. *In general, a back cast will not predict how these programs might perform in a random, high volatility market that lacks directional price bias in the future.* It was clear that depending on market conditions in any one year, that one methodology may outperform the others from a quantitative standpoint without respect for the desired qualitative objectives. *Although the quantitative analysis helped to validate MichCon's selection of the VCA methodology, it was not the over-riding determining factor because it did not provide any insight into the performance of this method in random price environments that may occur in the future.* (2 Tr 215, *emphasis added.*)

To further support its position that a historical back cast does not provide any insight into the performance of a fixed price method during future random price environments, Mr. Clinton performed two more in-depth analyses, which are embodied in Exhibit A-31. In the first analysis, he constructed a model using a series of randomly selected gas prices and calculated the resulting annual average cost of gas under both the VCA method and the Zero Hedge method. Mr. Clinton then ran the model 10,000 times, each using a different random selection of prices between \$3.00 and \$11.00.

This analysis shows that the VCA is much less volatile, because 95% of the time it will result in a cost of gas between \$6.21 to \$7.79 versus the Zero Hedge method, which will produce a much wider range between \$5.62 and \$8.38. (2 Tr 256.)

In his second analysis, Mr. Clinton constructed a similar model but used a series of prices that were determined from random price changes of plus or minus \$1.00 from any one month to the next with an initial price of \$7.00 and a minimum of \$2.00 in any given month. The results of this analysis were similar to the results of the first analysis, in that price volatility was significantly less under the VCA method as compared to the Zero Hedge method. More specifically, Mr. Clinton stated that for the 10,000 scenarios, the VCA method results in an average cost of gas of \$7.04 while the Zero Hedge method produced an average cost of gas of \$7.15. Furthermore, 95% of the time, using the VCA method resulted in a range between a low of \$3.85 to a high of \$10.54. In contrast, the Zero Hedge approach produced a much wider range between a low of \$2.43 to a high of \$13.13. (2 Tr 256-257.)

The foregoing evidence also supports rejection of the MCAAA's proposal to adopt the Zero Hedge strategy in lieu of the VCA method. Furthermore, the Administrative Law Judge agrees with Mich Con that the major problem with MCAAA's position is that Mr. Crandall's recommendations are not supported by any facts, data, or analysis. When asked on discovery to provide the information upon which he relied to form his opinion that the VCA method will be more costly, Mr. Crandall admitted that he did not prepare any analysis specific to Mich Con. Instead, he merely responded that, "It is a statement of the obvious that locking in 75% of the gas on a fixed price basis will be less costly only if the actual prices at the time of delivery rise above the forward

costs cost (sic) incurred at the time of the contract.” (Exhibit A-32.) Mr. Crandall then went on to cite analyses conducted by the Nevada PUC, which purportedly shows that the costs of forward purchases and hedging substantially exceeded the costs that would have occurred had the utilities “ridden the market.” First, the Administrative Law Judge notes that a “statement of the obvious” does not constitute evidence in a contested case proceeding. Second, analyses performed in other jurisdictions are not relevant to this proceeding and are not entitled to any weight.

Furthermore, there is also no record evidence to support Mr. Crandall’s two proposed modifications to the VCA method, i.e., reducing fixed price purchases from 75% to 33% and suspending gas purchases during price spikes. As to the first modification, Mr. Crandall again failed to provide any data or analysis to support his proposed 33%. As to the second modification, Mich Con correctly points out that Mr. Crandall did not even address suspension of gas purchases during price spikes. Instead, MCAAA attempts to improperly re-introduce proposed Exhibit MCA-4 into the record by attaching it to its brief. The Administrative Law Judge denied admission of this exhibit for lack of foundation and authentication. Thus, it constitutes extra record information that cannot be considered in this case.

The Administrative Law Judge further finds that the Attorney General’s recommendation that the Commission await a report from a collaborative intended to address gas supply strategies for Michigan gas utilities should also be rejected. In its November 12, 2009 order in Case No. U-15701, the Commission merely encouraged the parties to engage in discussions designed to identify modifications to the guidelines that may be implemented in the 2011-2012 GCR Plan year. According to Mich Con,

there is no currently active gas supply strategy collaborative, and no dates have been established for such meetings, although the idea of having a collaborative has been discussed. Thus, it is unclear whether such a collaborative even exists at this time. Moreover, the Administrative Law Judge agrees with Mich Con that a collaborative is informal and the outcome is not binding. Actual adoption and implementation of a gas supply strategy requires completion of an Act 304 GCR plan case, in which it is formally approved by the Commission.

In summary, the evidence supports the conclusion that Mich Con's proposed VCA method will provide protection from price risk and volatility through equal volume purchases over a period of time, thereby spreading risk evenly over time and volumes. This, in turn, will limit speculation and provide GCR factor stability and price certainty for customers. The Administrative Law Judge therefore concludes that it meets the objectives of a reasonable and prudent gas purchasing strategy.

#### Mich Con's Contingent Factor Mechanism

Mich Con requests a base GCR factor of \$7.06 per Mcf that can be increased quarterly by a contingency factor matrix dependent on increases in the NYMEX gas commodity prices.

In its November 12, 2009 order in Case No. U-15701, the Commission agreed with the Staff that Mich Con's contingency matrix should be simplified by reducing the number of fractional multipliers to a single fractional multiplier for each quarter. It adopted this single multiplier method, because it believed that Mich Con's multi-input method was unnecessarily complex.

Ms. Schmidt testified regarding the contingent factor mechanism and its implementation. She testified that Mich Con proposes to adjust the maximum factor using the more complex multi-input method. Ms. Schmidt stated that, based on its testing, Mich Con believes that this method is significantly better than the single multiplier method adopted by the Commission in Case No. U-15701. She stated that:

The multi-input method better mitigates underrecoveries and minimizes the inter-GCR year cost shifting that can occur from unmitigated underrecoveries resulting from increases in market prices. The results of MichCon's comparison between the single multiplier method and the more complex multi-factor methodology are shown in Exhibit A-26. The single multiplier method, calculated on page 8 of Exhibit A-26, result in a significant, \$49 million, underrecovery remaining at the end of the period, as shown on page 1 of Exhibit A-26. By comparison, the multi-input method resulted in no underrecovery. MichCon believes it is unacceptable to implement a contingent factor methodology that has a built in underrecovery of approximately \$49 million when the factor can be designed, albeit with a more complex formula, to prevent such an underrecovery. (2 Tr 321.)

In addition to proposing a return to the multi-input method, Mich Con also proposes a \$5.00 per Dth maximum NYMEX change, which is an increase from the 2008-2009 GCR Plan's \$3.00 per Dth maximum. Ms. Schmidt testified that the Company is proposing this change because its contingent factors for the 2008-2009 GCR Plan were insufficient to mitigate underrecoveries resulting from changes in NYMEX prices. She stated that this increase is therefore necessary for the contingent factor to accurately reflect possible future events. (2 Tr 327.)

The Staff presented the testimony of Nora B. Quilico, a Public Utilities Engineer, who offered another simplification to the contingent factor adjustment process adopted in Case No. U-15701. Ms. Quilico explained that in place of potential multiple factor adjustments allowed quarterly, the Commission would approve an annual base GCR

factor and a single maximum allowable GCR factor. The Company would then be allowed to bill within this range every month of the entire plan year. She also stated this method is preferable to the method that was approved in Case No. U-15701, because it is much easier to understand and administer, the number of tariff pages would be reduced, and the utility's customers would be more certain of what GCR factor they may be paying throughout the plan year. (2 Tr 522-523.)

Ms. Quilico explained how this method is similar to the contingent adjustment that the Commission approved in Case No. U-15701:

In Case No. U-15701, Staff filed a contingent matrix with an all inclusive fractional multiplier that was the same for each quarter. The single fractional multiplier represents the GCR factor adjustment needed as the market price of gas changes from what was assumed in the plan case. A single fractional multiplier of 0.515 was also calculated for this plan case. It was calculated using the same method as was described in Case No. U-15701. A \$1.00 and \$2.00 change in NYMEX prices is assumed and plotted along with the necessary GCR factor. The slope of this line, 0.515 for the 2010-2011 plan year, is the appropriate fractional multiplier. The linear regression plot can be seen on Exhibit S-1. (2 Tr 523.)

Ms. Quilico also explained that because this new method allows Mich Con more billing flexibility by allowing the Company to adjust the factor every month, the Staff recommends that the contingent adjustment cap be reduced from the \$3.00 level approved in Case No. U-15701 to \$2.50. As a result, she calculated a maximum allowable GCR factor of \$8.3475 per Mcf for this case. (2 Tr 524.)

In its brief, Mich Con states that it believes that the Staff's proposal has merit and agrees that it is more effective than the Company's proposal to mitigate underrecoveries resulting from unforeseen market price movements. However, it contends that the Staff's suggested maximum contingent amount of \$2.50 is too low. It submits that a more appropriate maximum contingency amount would be \$5.00 per Dth, because the

Company has experienced unforeseen NYMEX increases in excess of \$5.00 per Dth. Mich Con therefore recommends that the Commission either adopt its maximum base factor of \$7.06 per Dth, plus the Company's modified contingent factor matrix, or use the Staff's approach and add to the GCR base factor a NYMEX contingent adjustment amount of \$5.00 per Dth, which would result in a maximum allowable GCR factor for 2010-2011 of \$9.64 per Mcf.

The Attorney General takes the position that the Commission should adopt the same contingency mechanism it approved in Case No. U-15701. He asserts that the problem with the Staff's proposed contingency mechanism is that it violates Act 304, because it is not based on a future event. Mr. Miller explained that:

No part of Staff's proposed maximum allowable GCR factor of \$8.3475 per Mcf is contingent upon any future event. Staff's proposal would eliminate the contingency adjustment procedure that has been part of MichCon's GCR rates for many years. It would instead allow MichCon to charge at any time a GCR factor up to \$1.2875 per Mcf higher than the factor that MichCon itself developed as needed to recover its projected GCR cost of gas. (2 Tr 467.)

Mr. Miller criticized the Staff's presentation for its lack of any discussion about likely gas costs. In support of his view that the Staff's recommended factor of \$8.3475 per Mcf is not contingent on future NYMEX prices, Mr. Miller reviewed movements of the NYMEX futures market in the months since December 2009. Although the average NYMEX futures prices for the 2010-2011 GCR year rose during December 2009, they peaked at a level only \$0.80 per Dth higher than the prices that Mich Con used to project its GCR cost of gas. According to Mr. Miller, gas prices then started to decline and by late February 2010, they had fallen to levels below those used by the Company to develop its projected GCR cost of gas. Mr. Miller stated that since then, the NYMEX

prices for the 2010-2011 year have remained below the prices Mich Con used to develop its projected GCR cost of gas. As a result, Mr. Miller stated that any increase in the maximum allowed GCR factor above the \$7.06 per Mcf sought by the Company would lack cost justification at this time. In Mr. Miller's view, "[i]t is therefore fair to say that the Staff proposes to abandon the use of a cost-based adjustment to MichCon's GCR factor and substitute an inflated but fixed GCR factor ceiling based upon NYMEX gas prices higher than those that can reasonably be expected to occur." (2 Tr 468.)

The RRC also opposes the Staff's proposed change for the reasons expressed by Mr. Miller. Instead, it recommends replacing the current contingency mechanism with a quarterly contingency factor mechanism. Mr. Hollewa described the components of his mechanism as follows:

1. The Company may increase the filed GCR Factor by any amount up to \$0.50 if the NYMEX Futures Strip in any month for the First Quarter of the GCR Year shows higher gas prices than those contained in the filed GCR Plan.
2. If the GCR Factor was not increased in the First Quarter, the Company may increase the Filed GCR Factor by any amount up to \$0.50 if the actual NYMEX Close for the first three months plus the NYMEX Futures Strip in any month for the Second Quarter of the GCR Year shows higher gas prices than those contained in the filed GCR Plan.

However, if the cumulative increase in the First and Second Quarters exceeds \$0.50 and/or market volatility shows that an increase of up to \$1.00 is necessary in the Second Quarter alone, then the Company may increase the Filed GCR Factor by any amount up to \$1.00 in the Second Quarter. The maximum increase to the Filed GCR Factor is limited to \$1.00 overall for the first two quarters.

3. The Third Quarter review made in any month would follow the same process as the Second Quarter review except the cumulative increase would be raised to \$0.75 and market volatility would be raised to \$1.50. The maximum increase to the Third Quarter GCR

Factor is limited to \$0.75 and the maximum increase to the Filed GCR Factor is limited to \$1.75 overall for the first three quarters.

4. The Fourth Quarter review made in any month would raise the cumulative increase to \$1.00 and market volatility to \$2.00. The maximum increase to the Fourth Quarter GCR Factor is limited to \$0.75 and the maximum increase to the Filed GCR Factor is limited to \$2.50 overall for the GCR Year. (2 Tr 395-396.)

Mr. Hollewa also indicated that for every one of the contingent increases, the Company should be required to supply supporting documentation to the Commission and all parties to the GCR plan case. The RRC asserts **that** Mr. Hollewa's mechanism, which phases in factor increases through the GCR year, reduces rate shock and price volatility that would otherwise occur with larger contingency factor increases and allows the utility to collect at a higher monthly billing rate in those months when most of the gas is consumed.

The MCAAA opposes Mich Con's modifications to its NYMEX-based contingent factor mechanism. According to the MCAAA, the Company's proposal once again introduces unnecessary complexity to an already complex and unnecessary mechanism. Instead, MCAAA favors the outright elimination of the NYMEX contingent factor mechanism, because Michigan has in place the new energy acts of 2008, which provide for expedited rate increases, interim rate relief within six months, and a revenue decoupling mechanism, among other things. In the alternative, MCAAA suggests modifying the Staff's proposal by allowing a modest increment that could be added to base GCR rates in a given month, limited to a smaller amount such as 10% of the base factor.

The Administrative Law Judge finds that Mich Con's proposed modifications to its contingent factor mechanism should be rejected, because they are essentially the same

changes the Commission rejected in Case No. U-15701. The Commission found that the changes were overly complex and that the proposed increase in the cap was too great.

Similarly, the Administrative Law Judge finds that the RRC's proposed contingent factor mechanism is also overly complicated and should be rejected. As the Staff correctly points out, it contains four different contingent factor caps, one for each quarter, and uses a series of "if-then" statements regarding the increase allowed for a certain quarter based on the factor adjustment made the prior quarter.

In contrast, the Staff's proposal would further simplify the contingent factor mechanism it proposed, and which the Commission approved, in Case No. U-15701. The Intervenor all criticize the Staff's proposal, arguing that it is contrary to Act 304 because it is not based on a future event, and it is too open-ended. In particular, they focus on the fact that the Staff's proposed mechanism does not rely solely on changes in the NYMEX cost of gas. However, the Administrative Law Judge is not persuaded by these arguments and, instead, finds that Section 6h(6) of Act 304 supports the Staff's proposal. That section provides that:

In evaluating the decisions underlying the gas cost recovery plan, the commission shall consider the volume, cost, and reliability of the major alternative gas supplies available to the utility; the cost of alternative fuels available to some or all of the utility's customers; the availability of gas in storage; the ability of the utility to reduce or to eliminate any sales to out-of-state customers; whether the utility has taken all appropriate legal and regulatory actions to minimize the cost of purchased gas; *and other relevant factors*. . . .The factors ordered shall be described in fixed dollar amounts per unit of gas, but may include specific amounts contingent on *future events*, including proceedings of the federal energy regulatory commission or its successor agency. [MCL 460.6h(6).]

The foregoing section contemplates that other relevant factors, and not just the price of gas, may be considered in evaluating the reasonableness of the Plan. As the Staff correctly points out, to calculate the GCR factor, the Plan assumes numerous variables, besides the price of gas, to produce the projections that ultimately result in a base GCR factor. Consequently, the Administrative Law Judge is persuaded that such variables would qualify as other relevant factors for the Commission to consider. Moreover, although the current contingency mechanism is limited to increases in the market price of gas, it may encompass multiple future events, which may or may not happen. In short, the statute does not provide that the only contingency that may be considered is a change in the price of gas, and it does not require a specific trigger.

In addition to further simplifying Mich Con's contingent factor mechanism, the Staff's proposal will allow recovery of most of the cost of gas in the appropriate plan year, thus resulting in fewer underrecoveries being rolled over to the next plan year and less drastic GCR factor variability from year to year. In other words, allowing the Company to bill within a specific range will bring more stability to the GCR factor and minimize customers' exposure to large swings in the GCR factor. The Administrative Law Judge therefore finds that the Staff's modification to the contingent factor mechanism should be adopted.

On the other hand, the Administrative Law Judge is not persuaded that the cap on the contingent adjustment should be reduced from \$3.00 to \$2.50. Ms. Schmidt testified that when Mich Con has used the \$3.00 per Dth maximum NYMEX change, the contingent factor has been insufficient to mitigate underrecoveries. The Administrative Law Judge recognizes that allowing the Company the ability to adjust the GCR factor on

a monthly basis using the Staff's contingent factor mechanism will allow Mich Con to respond more quickly to price increases and, consequently, be more effective in minimizing such underrecoveries. However, the Administrative Law Judge finds that the Staff did not present a factual basis to support its proposed reduction in the contingent adjustment cap. The Administrative Law Judge is unable to determine how the Staff actually arrived at the \$2.50 cap, as opposed to any other reduced amount such as \$2.25 or \$2.75. The Staff's only support for reducing the cap is that, because Mich Con will be able to adjust the GCR factor on a monthly basis, it is simply reasonable to do so. Instead, the Administrative Law Judge finds that it is more reasonable and prudent to retain the \$3.00 cap on the contingent adjustment at this time and then reevaluate it in Mich Con's next GCR plan after the Company has gained experience using the more simplified contingent factor mechanism.

#### Financing Costs

Mich Con requests that the Commission allow it to recover, through the GCR process, reasonable and prudent financing costs that are currently not recoverable in the Company's prevailing rates or the GCR mechanism as currently designed. Mich Con presented the rebuttal testimony of Edward J. Solomon, Assistant Treasurer and Director of Corporate Finance for DTE and its subsidiaries including Mich Con, in support of its request.

Mr. Solomon described the financing costs at issue as those associated with short-term borrowings, which exceed the Company's existing committed bank credit facilities, to secure GCR gas supplies during a GCR plan year due to increased gas prices. He explained that they may include fees and other expenses associated with

arranging short-term borrowings and costs associated with natural gas supplier financing arrangements. Mr. Solomon specified that Mich Con is requesting recovery of these costs only in the event that the borrowings exceed \$431 million, and the 13-month average of gas in underground storage exceeds \$50.4 million. More specifically, the financing costs could include fees, interest costs, and other expenses related to the short-term borrowings. He stated that since the onset of the current turmoil in the financial markets, the cost of maintaining these short-term credit facilities has increased significantly. (2 Tr 112.) Mr. Solomon explained that these financing costs are not recoverable in the Company's base rates, because base rates only allow for recovery of working capital financing costs. (2 Tr 121-122.) Mich Con's request includes a proposal to amend the Company's tariff to change the definition of recoverable booked costs of gas to include these financing costs.

The MCAAA opposes Mich Con's proposal, arguing that it is not authorized by Act 304 and, in fact, it is beyond the scope of Act 304. In support of its position, the MCAAA presented the testimony of William A. Peloquin. Contrary to Mich Con's assertion, Mr. Peloquin testified that the costs at issue are capital costs, which are not a recoverable cost component of GCR clauses. He therefore stated that Mich Con is in the wrong forum. Mr. Peloquin explained that:

The proper forum for Mich Con's gas inventory short-term debt bank facility fees is a general rate case. The cost of capital is a major component of the ratemaking formula. Interest costs are recovered in the base rates set in general rate cases. If the capital cost of gas inventory is to be recovered in GCR rates, then the book investment of Mich Con's gas inventory should be removed from the working capital rate base in a general gas rate case. This would better ensure that all of the allocations are properly considered. (2 Tr 513-514.)

Mr. Peloquin also testified that the financial markets are finally moving towards normalcy. As a result, he concluded that Mr. Solomon's claim of drastic increases in short-term bank facility fees is a short-term aberration that should not be embedded in an adjustment clause. (2 Tr 515.)

The Staff also opposes Mich Con's proposal to include financing costs in the GCR clause, because a Plan case proceeding is not the appropriate forum in which to make this request. Rather, the Staff submits that in the event Mich Con's short-term borrowings actually exceed its existing committed bank credit facilities, the Company should propose a solution in its next general rate case filing.

On behalf of the Attorney General, Mr. Miller did not analyze Mich Con's proposal in any detail, because in his preliminary review, he could not determine exactly which financing costs would be eligible for inclusion in the GCR process. He also could not understand how Mr. Solomon proposed to coordinate recoveries through the GCR process with the working capital allowance the Company was claiming in Case No. U-15985, its then pending rate case. Mr. Miller therefore recommended that the Commission reject this proposal unless Mich Con clarifies the way in which it would operate and makes it less complex. (2 Tr 416.)

The Administrative Law Judge finds that Mich Con's request should be denied. The Company has failed to provide a factual basis to support expanding the definition of booked cost of gas to include incremental financing costs that exceed its existing credit facilities. Instead, the Company is seeking recovery of an amount that can only be determined after the fact and, consequently, its request is based on speculation regarding events that have not occurred. The speculative nature of these costs is

evident in Mich Con's statement that, ". . .in *unusual circumstances* where there are significant increases in the price of gas supply, *it is possible* that MichCon would be required to seek additional short-term borrowings in order to secure **sufficient** gas supplies." (Reply brief, p. 23, *emphasis added*.) Furthermore, the Administrative Law Judge agrees with the Staff and the Intervenors **that an Act 304** proceeding is not the appropriate forum in which to make such a request. As noted by the Staff, if and when a factual basis exists that supports the Company's request, then it should seek to expand its existing credit facilities in a rate case.

#### Mich Con Gathering Company (MGAT) Purchase Volumes

The Attorney General raised the issue of Mich Con's purchases of gas from MGAT, an affiliate of Mich Con. MGAT owns and operates the Antrim Expansion Project (AEP), which is a gathering system in the northern part of the Lower Peninsula of Michigan. Most of the gas gathered at the AEP is owned by the producers of that gas or by other shippers that have purchased the gas from the producers. After it is delivered to Mich Con at the outlet of AEP, Mich Con redelivers the gas to end-user customers on Mich Con's distribution system or to pipelines for further transportation. MGAT owns any gains or losses in gas volume that occur on the AEP, which are the difference between the quantity of gas delivered off the AEP to Mich Con and the quantity of gas delivered into the AEP by the producers using the AEP to gather their gas. Since 2004, the AEP has only been experiencing gains in gas volume, which is the gas that Mich Con has been purchasing from MGAT. In the past three years, ending March 2009, these purchases have ranged from approximately 700,000 Mcf per year to 900,000 Mcf per year. (2 Tr 443.)

Mr. Miller testified that the foregoing purchases have become a regular feature of Mich Con's gas purchasing activity, but the Company has never identified them in a GCR plan. Instead, Mr. Miller stated that Mich Con has recorded the gas it received from MGAT in its Exchange Gas Account, which explicitly appears in each of the Company's GCR reconciliations as part of the GCR cost of gas. The price Mich Con paid for the gas was based on the "Jurisdictional Rate," which is Mich Con's average cost per Mcf for all of its GCR purchases during a GCR year. (2 Tr 445.)

Mr. Miller identified two issues relative to Mich Con's treatment of the gas it receives from MGAT. The first issue is whether Mich Con should continue to treat the gas as an exchange included in the GCR process, accumulate it in that account for an unspecified period of time, and then make a decision after the fact about how best to dispose of the volumes of gas. The second and, in his opinion, more important issue, is the price Mich Con should pay for these deliveries when it purchases them. (2 Tr 446.) Mr. Miller raised these issues because, in his opinion, Mich Con has abused the Exchange Gas accounting for its receipt of gas from MGAT by accumulating the MGAT volumes in the Exchange Gas account at the Company's current monthly Jurisdictional Rate in effect at the time of the purchase, not at the time the gas was delivered, and then making the actual purchases at times when the Jurisdictional Rate was unusually high. In doing so, Mr. Miller opined that Mich Con has given an unjust preference to its affiliate and, in turn, charged unreasonable high prices to the GCR cost of purchased gas. (2 Tr 447-448.)

The Attorney General takes the position that, to prevent this abuse of the affiliate relationship, the Commission should modify Mich Con's GCR plan to include definitive

treatment for any gas that the Company may receive from MGAT during the 2010-2011 GCR year and throughout the five-year forecast period. Mr. Miller recommended the Commission require Mich Con to purchase all of the gas volume gains across the AEP at the fair market value of the gas at the time it is delivered to Mich Con. In his view, the fair market value of each month's deliveries should be the published Mich Con city-gate index price for that month, less 5¢ per Dth. (2 Tr 451.) Mr. Miller explained that the 5¢ per Dth deduction is supported by the fact that the MGAT deliveries are not a secure source of supply, because they are not predictable and Mich Con cannot count on those deliveries in its operational planning. (2 Tr 457.)

In rebuttal, Mr. Clinton testified that, contrary to Mr. Miller's testimony, the MGAT volumes should not be purchased at the monthly Mich Con city-gate published index price. Mr. Clinton testified that there are no facts or data in evidence to support Mr. Miller's recommendation and, instead, the appropriate basis for pricing MGAT purchases is the Jurisdictional Rate. Mr. Clinton stated that use of the Jurisdictional Rate is consistent with past practice approved by the Commission. (2 Tr 250.) Mr. Clinton also disagreed with Mr. Miller that the Mich Con city-gate index price should be discounted \$0.05 per Dth for MGAT purchase volumes due to the absence of supply security. He explained that these are secure volumes that are known and measurable at the time the purchase is made, which is the same reliability and certainty of price as any other contemporaneous supply purchase. He also claimed that the discount would be discriminatory compared to Mich Con's cash-out mechanism for receipts at the Company's dry receipt points. That mechanism states that if the monthly imbalance percentage is 2% or less of actual deliveries then the cash-out price for excess

quantities is equal to 100% of the Gas Daily Mich Con city-gate monthly **index** price. In Mr. Clinton's view, that approach should be applied to its entire purchase from MGAT, because the MGAT volumes are less than 2% of the entire volume that Mich Con receives. (2 Tr 251-252.)

In its brief, Mich Con states that this issue has already been litigated in Case No. U-15451 and, consequently, it will most likely be rendered moot for purposes of this case because the order in Case No. U-15451-R will in all likelihood be issued prior to the Commission's decision in this proceeding. Nevertheless, for completeness in this case, the Company simply adopts its position as stated in its brief in Case No. U-15451-R. That position is that the MGAT purchases, which began in 2005, were made at the then current Jurisdictional Rate and were originally identified and reviewed by the Staff in its audit of Case No. U-14401-R. Since then, the Company's treatment of the MGAT purchases has not changed, i.e., it has continued to accrue the volumes in the Exchange Account for eventual sale to Mich Con at the Jurisdictional Rate. Mich Con submits that the review and tacit approval of MGAT sales in proceedings since 2005 has contributed to its conclusion that this was the appropriate treatment.

In further response, Mich Con asserts that the Attorney General has failed to present any evidence that there is any form of abuse or manipulation by the Company that provides any financial advantage to MGAT. It submits that the only aspects of the purchases from MGAT that are arguably germane to this GCR plan case are how future purchases should be priced and whether they should be listed as a planned source of supply in a plan case. Mich Con contends that considering MGAT as a planned source of supply in a plan case is inappropriate for two reasons. First, MGAT does not sell gas

supply to anyone, and it does not produce gas. Rather, MGAT simply operates pipelines for transport of other parties' gas and has facilities that interconnect with Mich Con. Thus, the Company states that treating MGAT as a planned source of supply in the Plan case presumes there is a gas supplier-purchaser relationship between Mich Con and MGAT that simply does not exist. Second, the Company points out that while recent history indicates a continuing positive MGAT imbalance on Mich Con's utility system, the imbalances have not always been positive over the life of the interconnection and the magnitude of the gain has not been consistent year over year. Consequently, the Company argues, there is no way for it to establish in its GCR plan a specific amount of gas supply that will be provided by the MGAT imbalance.

In its reply brief, Mich Con states that although MGAT should not be listed as a planned source of gas supply in a GCR Plan, it agrees that its Plan can formally acknowledge what has informally occurred historically, i.e., the Company will use any MGAT gains that may occur as GCR gas supply. In addition, Mich Con now states that pricing MGAT purchases at the price published at Mich Con's city-gate index for that month is a reasonable change to which the Company does not object. However, it emphasizes that prospective implementation of this change in pricing MGAT volumes must acknowledge gas supply activity that has already occurred, regardless of whether that determination is made in the Commission's order in Case No. U-15451-R or in its order in this case.

The Administrative Law Judge finds that Mich Con should be required, beginning with the Company's next GCR Plan case to be filed in December 2010 for the 2011-2012 GCR period, to formally acknowledge in its GCR Plan filings that it will use any

MGAT gains that may occur as GCR gas supply. She agrees with the Company that, because the imbalances have not always been positive over the life of the interconnection, it is not possible to establish in its GCR Plan a specific amount of gas supply that will be provided due to the MGAT imbalances. She further finds that Mich Con should be required, on a prospective basis, to price all future purchases of gas delivered by MGAT at its fair market value. She agrees with Mr. Miller that fair market value should be measured at the time MGAT delivers the gas to Mich Con, because that is when it is recorded as entering the GCR process. As Mr. Miller noted, the fair market value of the MGAT deliveries is the price that MGAT could obtain if it sold that gas to a purchaser other than Mich Con. It is also the price that Mich Con could obtain if it sought to purchase a similar supply from another vendor. (2 Tr 453.) Furthermore, the evidence demonstrates that the MGAT deliveries are not a secure source of expected supply and, therefore, application of the Jurisdictional Rate, which includes the costs of the Company's fixed price purchases that are more secure, is inappropriate. (2 Tr 460.)

On the other hand, the Attorney General's proposal to apply a reduced city-gate index price to the MGAT gas should not be adopted. Mr. Miller did not provide any explanation as to how he arrived at his recommended discount other than to state that in his judgment, the fact that Mich Con has to take whatever quantities of gas MGAT delivers to it has a value of 5¢ per Dth. In other words, the Administrative Law Judge is unable to determine how Mr. Miller came up with the specific amount of 5¢ per Dth, as opposed to any other amount. Moreover, because the fair market value of the MGAT deliveries is the price that it could obtain if it sold that gas to another purchaser, it would

be unreasonable and discriminatory to discount the price Mich Con pays for the MGAT volumes.

### Affiliate Purchases

The Attorney General also raised the general issue of Mich Con's purchases from affiliates like MGAT and DTE Energy Trading. Mr. Miller presented extensive testimony on this issue, in which he addresses the concerns related to such transactions and recommendations as to how the Commission should address those concerns. (2 Tr 429-442.) In particular, Mr. Miller opined that purchases from affiliates present a possible opportunity for Mich Con to abuse the GCR process by paying an inappropriately high price to its affiliates and then recovering those high costs from its customers. He also believes that purchases from affiliates may create a financial incentive for the utility to incur higher costs for its purchases from unaffiliated suppliers, which is an incentive for the utility to inflate its total cost of purchased gas. (2 Tr 431-432.) In short, Mr. Miller is concerned that such transactions allow the utility to give a discriminatory preference to its affiliates.

Mr. Miller therefore recommended that the Commission limit the allowable quantity of Mich Con's purchases from its affiliates to 1% or perhaps 1.5% of Mich Con's total purchases from all sources. He submits that if Mich Con wishes to exceed this limit, it should present its proposed affiliate purchase contracts to the Commission for advance approval, and purchased quantities approved in advance would not count against this cap. The Attorney General also recommends that the Commission should not allow Mich Con to recover from its customers any amounts higher than the index price of its purchases from its affiliates. The Company would still be required to

demonstrate, in the reconciliation proceeding, that the price paid to an affiliate is at least as favorable as the best offer available from an unaffiliated seller. (2 Tr 434-435.

The Administrative Law Judge finds that the Attorney General's proposal to restrict affiliate purchases should be rejected at this time, because it is not supported by any record evidence. The only basis for limiting affiliate transaction to 1% or perhaps 1.5% is speculation and concern that purchases from affiliates present a "possible opportunity" for Mich Con to abuse the GCR process by paying its affiliates inappropriately high prices and then recovering those costs from its customers. However, when asked if he had any affirmative evidence that Mich Con has failed, either by design or even just by lack of sufficient effort, to obtain the best available arrangements for any of its gas purchases, Mr. Miller admitted that he did not have any such evidence. (2 Tr 441.) The Administrative Law Judge agrees with Mich Con that adopting the Attorney General's proposal would be tantamount to finding the Company guilty of affiliate abuse without any evidence.

### **CONCLUSION**

The Administrative Law Judge concludes that Mich Con's GCR plan and five-year forecast are reasonable and prudent as modified by this decision. She therefore

recommends that the Commission issue an order adopting her findings and conclusions and approving a maximum base GCR factor of \$7.06 per Mcf.

STATE OFFICE OF ADMINISTRATIVE  
HEARINGS AND RULES  
For the Michigan Public Service Commission

---

Barbara A. Stump  
Administrative Law Judge

ISSUED & SERVED: August 5, 2010